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SUBJECT: OUTLOOK POSITIVE FOR ORGANIZED RETAIL IN INDIA

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11. (SBU) Summary: Despite a series of protests and a lack of political support for corporate retailers in a number of states, the corporations themselves, as well as industry groups, analysts, and government officials, remain optimistic that organized retail will grow and thrive in India. Spencer's and Pantaloon Retail indicated that recent turmoil has not caused them to abandon their ambitious plans, but they and others are revising their strategies to ensure that small retailers and middlemen have a stake in the growth of organized retail. The degree of policy tumult occasioned by the new Mayawati government in Uttar Pradesh, India's most populous state and an object of desire for every major retail player, has surprised many in the sector. However, most believe the state will eventually accept organized retail. All of Econoff's contacts felt FDI in multi-brand retail would come within a few years, and several mentioned that foreign companies should expect to meet resistance when they enter the Indian market. Post recommends for U.S. companies an entry strategy that focuses on inclusive growth, as well as a capacity to tolerate the inevitable protests. End summary.

A WIN-WIN-WIN SITUATION

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12. (SBU) In Econoff's discussions with corporations, industry groups, and government agencies, and a clear consensus emerged that there are simply too many positives to organized retail for political opposition to impede its growth for very long. Besides the corporate retailers, three key stakeholders--consumers, farmers, and governments--are likely to reap tremendous rewards from organized retail. The consumer will get better prices, more variety, and a more comfortable shopping environment. Most sources agreed that India's millions of farmers will get a better return on their crops when organized retailers purchase directly and develop a modern supply chain, increasing their share of the final 'retail rupee' from the current 35 or 40 percent claimed in a recent report by policy-advisory company CRISIL closer to the 65 percent farmers get in countries with higher penetration of organized retail. Ministry of Agriculture Joint Secretary for Marketing U. K. S. Chauhan finds a confluence of corporate and GOI goals here, as the GOI is exploring ways to improve farmers' incomes and reduce food costs for consumers. Further, as Spencer's Zonal Merchandizing Head Pramod Kumar explained, governments gain from organized retail because corporations pay their taxes, whereas many small retailers do not claim their true incomes and thus produce less tax revenue.

13. (SBU) Despite this, organized retailers have garnered little support from the central government and the governments of Uttar Pradesh (UP), West Bengal, Madhya Pradesh, and other states. Chauhan said plainly that the Agriculture Ministry is "keen on organized retail," and Anindya Acharya, Deputy Director of the Confederation of Indian Industry (CII), said that Commerce Minister Kamal Nath is equally supportive. With the specter of mid-term elections on the horizon, though, political parties are risk-averse. Politicians are more concerned with the votes they can get from the unorganized sector than with sound economic planning. Prudent decisions on sensitive policy issues, all sources agreed, will have to wait for more stable times.

14. (SBU) What makes organized retail such a sensitive issue is the political influence of the middlemen in the traditional agri-retail supply chain, said Chauhan, admitting that middlemen have valid concerns. As for small retailers, early findings from a report by the Indian Council on Research for International Economic Relations show that organized retail is unlikely to negatively affect them. Said Mayur Toshniwal, Vice President for North India of Pantaloon Retail, "We can't compete with local vendors," because the nation's 12 million mom-and-pop shops offer convenient locations, delivery options, a level of personal interaction, and occasional credit that organized retailers cannot match. Chavi Hemanth, Senior Assistant Director of the Federation of Indian Chambers of Commerce and Industry (FICCI), added that many Indians enjoy the traditional shopping experience and guessed that at most, only one in 20 small retailers would go out of business because of competition with corporate players.

THE WORST HAS PASSED

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15. (SBU) Both Pantaloon and Spencer's conveyed the sense that they had weathered the storm, after numerous protests against organized

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retail in the past few months. FICCI's Hemanth said the protests had already reached their peak, and Spencer's General Manager of Operations Tarun Arora mentioned that an October 10 demonstration in Mumbai won only a fraction of the 50,000 to 100,000 participants that organizers had projected, with farmers and small retailers staying away.

16. (SBU) Almost everyone with whom Econoff spoke also remarked on the similarity between the recent protests against organized retail and past unrest when the GOI liberalized the insurance, print-media, and other sectors. Toshniwal called such protests "a generic problem of democracy," commenting that they are part and parcel of doing business in India and that they rarely have a lasting effect.

FOCUS ON INCLUSIVE GROWTH

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17. (SBU) Still, Purnendu Kumar, Associate Director of Technopak Advisors--a consultancy firm working with Wal-Mart, Reliance, the Aditya Birla Group, Shopper's Stop, Mahindra Retail, and others--acknowledged that there is enough opposition to organized retail to persuade companies to adjust their strategies. Technopak is advising clients to consider how they can involve supply-chain middlemen and small retailers in their growth. Kumar suggested employing traders as advisors to help with supply consolidation, something Spencer's two representatives said they have already begun.

18. (SBU) Chauhan, on the other hand, said, "I don't think we should bother much" about the middlemen. He argued that they will be forced to pursue alternative employment anyway as the agri-retail supply chain improves over time and that companies should focus on mitigating the impact of organized retail on mom-and-pop stores by allowing them to operate as franchises or at least purchase from the big companies' distribution centers. He also recommended that companies invest in training farmers in modern farming techniques as well.

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¶9. (SBU) The mention of UP evoked laughter and head-shaking from more than one source and anguish from others. Pantaloon's Toshniwal said that he expected problems in Kerala and to some extent in West Bengal, where Left governments are in power, but the political upheaval in UP came as a surprise. He referred to August 23, the day UP Chief Minister Mayawati ordered all stand-alone retail outlets in the state to close their doors, as "a black day for the industry."

¶10. (SBU) When Mayawati issued her closure order, she also convened a committee to analyze the potential impact of organized retail in the state and gave a one-month deadline for the committee's report. Technopak's Kumar believes that the report will never come, that Mayawati was never committed to a sincere analysis. The press has, by and large, ignored the issue of the overdue report, but business daily The Mint indicated on October 22 that the committee had met just once since August 23, had not scheduled a second meeting, and would not commit to a date for the final report.

¶11. (SBU) Despite the lingering uncertainty, organized retailers anticipate good returns on their investment in UP. Mayawati recently announced that she has decided in principle to impose the Value Added Tax (VAT) that is already in place in every other state, and Spencer's Kumar thinks this will make all the difference. If UP implements the VAT over expected protests from traders' unions, Kumar believes that Mayawati will quickly realize the enormous income UP could get from organized retailers and will put in place more retail-friendly policies, opening the door to the most populous state in India.

#### RELIANCE SEEN AS A BRUTE AND A BELLWETHER

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¶12. (SBU) Reliance seems to come up in any conversation about retail these days, as almost all of Econoff's contacts mentioned the indigenous giant, most in a grudgingly admiring way. Toshniwal said that the Reliance conglomerate has a history of targeting and knocking out small competitors and entered into grocery retail with the same designs. He felt Reliance opened with far too much fanfare

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and advertised prices that small retailers would find "predatory." He said that Pantaloon, by contrast, was not trying to acquire existing market share, but striving to expand the market. Chauhan found Reliance's entry strategy flawed, in that they opened stores before developing relationships with farmers or initiating any of the supply-chain improvements that would yield higher market realization for them.

¶13. (SBU) In UP, Reliance has fired nearly 1000 workers and plans to terminate all of its leases. Yet Hemanth described Reliance's firings as tactical, a move intended to communicate to the government that a policy unfriendly to modern retail was unacceptable and would preclude employment options.

#### FDI: JUST A QUESTION OF WHEN AND HOW

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¶14. (SBU) All sources concurred that the Center will allow FDI in multi-brand retail within five years, but the exact timing is uncertain. Hemanth does not expect it in the next two years, except perhaps for non-sensitive goods like sports equipment and consumer electronics. Purnendu Kumar said that whenever the next government comes into power, it will permit FDI in multi-brand retail.

¶15. (SBU) Hemanth emphasized to Econoff that any new policy allowing FDI will come with riders, such as limits on the locations of outlets and on the number a company can have in a given area. Shrivastava said that the government should and probably will require international players to procure a certain percentage of their merchandise locally.

¶16. (SBU) Nearly all of Econoff's sources were optimistic about what

FDI will do for multi-brand retail. Spencer's Arora and Kumar expressed their support, saying that foreign players will bring in new technology, best practices, and, most importantly, new strategies for increasing consumer spending. Arora estimated that the Indian market can easily support 10 to 15 large players. Technopak's Kumar predicted that the four major Indian retailers down the road will be Reliance, the Aditya Birla Group, Pantaloon, and Spencer's, and he thought that they would coexist comfortably with Tesco, Wal-Mart, and other foreign companies, although he speculated that Spencer's and Pantaloon might sell out.

COMMENT: TRY FOR A RIPPLE, BRACE FOR A WAVE

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¶17. (SBU) India's billion consumers, by and large, do not need convincing that more options and better prices are in their interest, and as Purnendu Kumar noted, most Indians do not care whether they shop at an Indian or foreign-owned store. Companies should first emphasize the benefits they can offer to farmers and others who stand to gain from improvements in agri-retail infrastructure. As Hemanth put it, the most persuasive case for organized retail is that it improves GDP, increases employment opportunities, and reduces the urban-rural divide. Once stores are up and running, retailers who have met fairly little resistance, such as Spencer's and the Aditya Birla Group, have sought differentiation through product variety and quality rather than through price, which small retailers seem to see as less threatening.

¶18. (SBU) Regardless of how quiet entry might be, however, U.S. companies should expect some resistance, which is a cost of doing business in India. Toshniwal said that based on his experience working in the U.S. office of Coca-Cola, he thinks American companies are oversensitive and need to recognize that things work a little differently in India. U.S. companies that agree to the terms of the Indian experience will have the best chance of establishing themselves quickly once the GOI approves FDI. End comment.

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